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FEDERAL COMMUNICATIONS COMMISSION
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Before the

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20054

In the Matter of	)	
	)	CC Docket No. 95-116
Telephone Number Portability	)	

REPLY COMMENTS OF U S WEST, INC.

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SUMMARY

In these reply comments, U S WEST, Inc. asks the Commission to pay particular attention to the difficulties LECs will face in recovering the massive costs they must incur to meet the federal number portability mandate. We also respond to other commenters' proposals on the allocation of industrywide ("Type I") and carrier-specific ("Type II") costs among carriers. The comments make three main points:

1. **The Commission must enable carriers to recover all their costs of compliance with the number portability mandate.** Although competitive LECs already possess the regulatory flexibility they need to recover their costs (and affirmative Commission regulation of that recovery would only be counterproductive), incumbent LECs need affirmative authorization to levy a federal number portability surcharge that will enable them to recover their compliance costs as promptly as possible. The Commission should not (and legally may not) leave the question of cost recovery to the states, even where states opt out of the regional SMSs. Moreover, the Commission must allow carriers to recover all their compliance costs, including the costs of network modifications undertaken or accelerated solely to meet the federal portability mandate and the Commission timetable. The Commission should not treat these modifications as it did in the 800-database proceeding, given that the costs of local number portability are many times higher and the very implementation of local number portability makes the future recovery of these costs uncertain.

2. **The Commission should allocate Type I costs to all carriers from a single national pool on the basis of retail telecommunications revenues.** For all allocation

questions, U S WEST asks the Commission to take the administratively simplest and least burdensome approach. Specifically, the Commission should allocate commonly incurred Type I costs to individual carriers from a single national pool rather than requiring multistate carriers to allocate their revenues to the different regions (or individual states) served by each SMS. Because these costs must be recovered from retail end users, the Commission should allocate common costs on the basis of each carrier's retail presence — the best proxy for which is the carrier's retail telecommunications revenues. Finally, the Commission must reject allocation methods that do not recover costs from "all" telecommunications carriers, as Congress expressly required.

3. The Commission should not require any carrier to subsidize another carrier's Type II costs. Whereas Type I costs are incurred by third-party administrators and are therefore necessarily pooled, Type II costs are by definition incurred by carriers individually. The Commission should not create an administratively complex pooling regime to shift these costs from carrier to carrier. Each carrier should recover its costs from its own end users (including resellers) and from purchasers of unbundled network switching who rely on the unbundling carrier to provide number portability.

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U S WEST, Inc. submits this reply to the comments filed in response to the Commission's Further Notice of Proposed Rulemaking, 11 FCC Rcd 8352 (1996) ("FNPRM"). As set forth in U S WEST's opening comments, the question of how carriers will recover the enormous costs of implementing the federal number portability mandate is just as important as the issue addressed in the bulk of the FNPRM: how number portability costs will be allocated among individual carriers. Below, we first respond to the comments of other parties concerning the principles of cost recovery that the Commission should apply here. We then reply to the comments filed on the allocation of industrywide ("Type I") and carrier-specific ("Type II") costs.

ARGUMENT

I. Each Carrier Must Have the Opportunity To Recover Its Full Cost of Implementing Number Portability.

As noted in U S WEST's opening comments, because local number portability is a federal mandate, the Commission itself is obligated to provide a federal method of cost recovery.[1] In addition, the Commission must allow carriers to promptly recover all costs that are, in its words, "directly related to providing number portability" — including the costs of network modifications that carriers would not deploy in the absence of the federal number portability mandate or must deploy ahead of schedule solely to meet the Commission's timetable. Finally, the Commission need not and should not regulate the methods new entrants use to recover their number portability costs (for example, whether they use a surcharge and, if so, how large), and it should give incumbent LECs the same flexibility to recover their costs.

Various commenters argue that cost recovery matters should be left to the states, oppose the use of optional flat surcharges, or narrowly define the costs that incumbent LECs should be able to recover. As set forth below, the Commission should reject these arguments.

A. Federal Mandates Require Federal Cost Recovery.

Many commenters agree with U S WEST's position that the Commission should as a matter of policy, and must as a matter of law, expressly provide some federal mechanism that enables carriers to recover their costs of complying with the federal mandate.[2] Several state public utility commissions oppose the idea of a federal cost recovery mechanism, suggesting instead that the states must be allowed to set the process by which costs may be recovered.[3] Their opposition is ill-founded.

1/ U S WEST at 5-9.

2/ *See, e.g*, Bell Atlantic at 2; GTE at 8-10; MFS at 8; NYNEX at 11-12; SBC at 14-15; Teleport at 6-7; United States Telephone Association ("USTA") at 17.

3/ *See, e.g.*, California Public Utility Commission ("CaPUC") at 9-11; Colorado Public Utility Commission Staff ("CoPUC Staff") at 5-6; Illinois Commerce Commission ("ICC") at 4-5, 6; New York Department of Public Service ("NYDPS") at 2; Public Utilities Commission of Ohio ("PUCO") at 1-2, 5-7.

The state commissions' arguments are premised on an incorrect proposition: that the number portability ordered by Congress in the Telecommunications Act of 1996 is subject to state rather than federal jurisdiction. While number portability supports intrastate as well as interstate calling, carriers must provide it pursuant to a federal mandate and in accordance with federally prescribed requirements.[4] Congress explicitly assigned the Commission the responsibilities of determining when carriers should deploy number portability and how they should bear the costs of complying with this new federal mandate.[5] As the Commission properly recognizes in its First Report and Order, this mandate is justified by overriding federal interests in ensuring network interoperability, conserving telephone numbers, and promoting competition in telephony.[6] There cannot practicably be separate number portability regimes and architectures for intrastate and interstate calls. Realistically, the same system will enable a given CLEC customer with a ported number to receive local, intrastate toll, and interstate calls. This dominant federal interest in number portability, notwithstanding that it partially supports intrastate calling, marks it as a service subject to paramount federal regulation.

As demonstrated in U S WEST's opening comments, the Commission is legally obligated to specify a mechanism for recovering the costs imposed by this federal mandate and provided under the Commission's jurisdiction. The Commission may not depend on the states to make up any shortfall in its own cost recovery mechanism, much less to make up for the absence

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[4] 47 U.S.C. § 251(b)(2) (ordering LECs "to provide, to the extent technically feasible, number portability in accordance with the requirements prescribed by the Commission"); 47 U.S.C. § 251(d)(1) (ordering Commission to adopt implementing regulations).

[5] 47 U.S.C. § 251(e)(2).

[6] 11 FCC Rcd 8352, 8354, 8370-71 (1996).

of a mechanism, just as the states may not unilaterally shift the costs of providing services under their jurisdiction to the federal base.[7]

Moreover, it makes strong policy sense for the Commission to prescribe an explicit cost recovery mechanism. Just as different state technical standards and database architectures would threaten the achievement of the federal policies identified above,[8] reliance on a varied assortment of state pricing and cost recovery mechanisms would likewise threaten these policies by risking the possibility that carriers might be unable to recover the costs needed to turn the federal mandate into reality.[9] The Commission appears to recognize this last principle as well, and U S WEST endorses its tentative conclusion that it should prescribe a pricing and cost recovery mechanism that all states must follow — including states that opt out of the regional databases.[10]

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[7] *See* Smith v. Illinois Bell Tel. Co., 282 U.S. 133, 148-49 (1930) (state regulators have "no authority to impose intrastate rates, if as such they would be confiscatory, on the theory that the interstate revenue of the company was too small and could be increased to make good the loss"); Hawaiian Tel. Co. v. Public Util. Comm'n of Hawaii, 827 F.2d 1264, 1275 (9th Cir. 1987), cert. denied, 487 U.S. 1218 (1988) (invalidating state separations formula that failed to provide for recovery of all costs assigned to the state's jurisdiction); National Ass'n of Regulatory Util. Comm'rs v. FCC, 737 F.2d 1095, 1113-14 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1985) ("Under Smith, a portion of the costs of [the local telephone plant] are assigned to the interstate jurisdiction, for recovery under the regulatory of the FCC. . . . Local telephone plant costs are real . . . and they must be recovered regardless of how many or how few interstate calls . . . a subscriber makes.").

[8] *See* First Report and Order, 11 FCC Rcd at 8403 (ordering that state-specific databases for states opting out of the regional SMSs must "meet the national requirements and operational standards recommended by the NANC and adopted by this Commission" and "must be technically compatible with the regional system of databases and must not interfere with [their] scheduled implementation"; otherwise, Commission will override states' decisions to opt out).

[9] *See* Hawaiian Tel. Co., 827 F.2d at 1275 (where regulator fails to provide recovery of costs assigned to its jurisdiction, the danger exists that "some costs of plant and expenses would not be included in the rate computations of either the PUC or the FCC").

[10] *See* FNPRM, 11 FCC Rcd at 8460 ("[W]e tentatively conclude that the pricing for state-specific databases should be governed by the pricing principles established in this proceeding. We believe that the use of our pricing mechanism — even in states that opt out of the regional database system — will help to maintain consistency between states, thereby improving the likelihood that competition will develop nationwide.").

B. Carriers Should Be Free To Recover Their Number Portability Implementation Costs from End Users through a Distinct, Flat Surcharge.

Many commenters agree with U S WEST that the federal cost recovery mechanism discussed in the previous section should take the form of an explicit, non-traffic sensitive surcharge that all LECs may, at their option, levy on end users.[11/] As U S WEST noted in its opening comments, recovering these costs through a flat surcharge, as opposed to bundling them into per-minute access charges or local telephone rates, would minimize the distortion of demand for service and be consistent with past Commission practice. Such a flat surcharge also would be consistent with the preference in the Communications Act for making subsidy mechanisms explicit and basing service and element rates on actual costs.[12/]

Several commenters leave the possibility of such a surcharge aside and instead debate how exactly the costs of deploying number portability would be treated under the Commission's price cap rules — whether as exogenous costs or as components of some existing or new cost basket.[13/] This attention is misplaced. Any changes to the price cap rules would become obsolete almost immediately, and debate over the details would serve no useful purpose.

First, the Commission has promised imminent reform of access charges. If that reform removes current subsidies by reducing access charges to economic costs, the Commission

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11/ *See, e.g.*, California Department of Consumer Affairs ("CaDCA") at 22; Cincinnati Bell at 6-7; NYNEX at 12-13; PacTel at 10-11; SBC at 10, 12; USTA at 19.

12/ U S WEST at 12.

13/ *See, e.g.*, AT&T at 6-9; Frontier at 3-5; MCI at 12-13; PacTel at 12.

presumably would remove any number portability costs from access charges. Bundling number portability costs into access charges now would simply defer — and not for long — the day the Commission must decide how these costs are to be recovered.

Moreover, under the Commission's recent Interconnection Order, all IXCs will be able to avoid paying access charges less than a year from now, at the latest,[14] and will be able to purchase unbundled network elements in place of access.[15] As a result, to the extent that the Commission requires carriers to rely on access charges to recover any portion of their number portability costs, that portion will likely go unrecovered.

For these reasons, the Commission should permit all carriers to recover number portability costs through a surcharge on all end users and purchasers of unbundled network switching. Only that mechanism would provide incumbent LECs a reasonable assurance of recovering those costs.

C. The Commission Must Enable Carriers To Recover All the "Directly Related" Costs of Implementing Number Portability.

U S WEST's opening comments endorsed the Commission's tentative distinction between industrywide shared number portability costs, "carrier-specific costs directly related to providing number portability," and "carrier-specific costs not directly related to number

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[14] The latest date for phasing out access charges is June 30, 1997. *See* Implementation of the Local Competition Provisions in the Telecommunications Act, CC Docket No. 96-98, FCC 96-325, at ¶ 30 (Aug. 8, 1996) ("Interconnection Order").

[15] 47 U.S.C. § 251(c)(3).

portability."[16] However, we asked the Commission to pay special attention to how the second category of costs is defined, as the Commission appeared to exclude from that category certain "directly related costs" — namely, the costs of network modifications that are deployed solely to comply with the federal number portability mandate, or whose deployment is accelerated solely to meet the Commission's timetable. U S WEST's opening comments established that these costs of unplanned and accelerated upgrades are both analytically distinct and easily segregable from other network modification costs, a conclusion with which other carriers who must bear these costs concur.[17] In addition, U S WEST demonstrated that a failure to segregate network modification costs that are "directly related to providing number portability," and to permit their recovery through a non-traffic sensitive surcharge, would distort per-minute access pricing and service demand in contravention of the goals of the Communications Act. Other commenters agree and note further that a failure to permit recovery through a surcharge would be the effective equivalent of a declaration that these costs are to go unrecovered, since (as noted above) IXCs will soon be free to substitute purchased network elements for access and the Commission is considering removing subsidies from access charges altogether.[18]

Other commenters would deny carriers explicit recovery of segregable network modification costs that are incurred solely as a result of the federal number portability

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[16] FNPRM, 11 FCC Rcd at 8459-60.

[17] *See, e.g.*, BellSouth at 6; GTE at 4; NYNEX at 3-4; USTA at 2. Even some non-carriers agree that these costs are properly recoverable: the California Department of Consumer Affairs, for example, notes that if "technology upgrades would not need to occur for several years, if at all, absent the implementation of LNP, then it is possible that those costs, or some portion of them, should be treated as LNP specific costs." CaDCA at 9.

[18] *See, e.g.*, Bell Atlantic at 7.

mandate.[19] These commenters do not adequately explain how these unplanned or accelerated modification costs are different from any other carrier-specific costs causally attributable to number portability. Instead, they argue for treating these costs differently because (1) these modifications benefit LECs by enabling them to provide CLASS services other than number portability, and (2) the Commission did not allow explicit recovery of network upgrade costs in the 800-database proceedings. Neither reason is valid.[20]

The economically proper way to account for the benefits that carriers would receive from deploying network modifications that they otherwise would not have deployed is to net the present value of these expected benefits against the costs of deployment, not to deny recovery of these costs altogether. No commenter has shown that the expected revenues from these new CLASS services would be high enough to make the net costs of deploying unplanned or accelerated modifications not worth the effort to account for them separately.[21] Indeed, as U S WEST demonstrated in its opening comments, any such revenues are at most hypothetical and insubstantial.[22] That is why incumbent carriers had not included such modifications in their network planning in the first place.

Nor is the second justification persuasive. Commenters who urge the Commission to follow mechanically the course of the 800-access decision overlook the

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[19] *See, e.g.*, AT&T at 17-18; Omnipoint at 7; Teleport at 9.

[20] It is unclear why these commenters oppose LECs' recovery of number portability costs since, so long as each LEC recovers those costs from its own retail customers, such recovery will not affect other carriers.

[21] The Commission would be able to track the revenues from such services through the reports that U S WEST has recommended LECs submit. U S WEST at 21.

[22] *See* U S WEST at 11.

enormously greater costs involved here. In its 800-access proceedings, the Commission did not think it necessary to recover the cost of network upgrades through direct surcharges outside the separations process because the entire cost of those upgrades (including already-planned upgrades as well as unplanned and accelerated ones) was less than $100 million for the seven RBOCs combined.[23] As a result, the distortion of prices caused by loading these costs into state and federal per-minute charges was likewise relatively modest. By contrast, the incremental network modification costs for all carriers required for federal number portability will reach into the billions of dollars. The resulting distortion of prices from efficient levels would accordingly be far more severe.

In addition, in contrast to the 800-access requirements, full portability will have a direct adverse effect on incumbent LECs' opportunities to recover their deployment costs. The full deployment of interstate 800-access did not have a significant impact on the ability of LECs to recover their costs of providing 800 access: An 800 customer's change from one IXC to another did not cause the LEC to lose revenue. Thus, the failure to provide a particular federal cost recovery mechanism did not present a risk that those carriers would be unable to recover those costs from future revenues.

Here, on the other hand, the Commission is requiring incumbent LECs collectively to spend billions of dollars on assets to facilitate a competitive marketplace for local exchange services. Whether incumbent LECs will be able to recover their implementation costs over the longer term from a customer base reduced by the impact of competition becomes more

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[23] Provision of 800 Access Service, Report and Order, 4 FCC Rcd 2824, 2833 (1989), aff'd, 6 FCC Rcd 5421 (1991).

uncertain. This uncertainty is heightened by the broader introduction of competition in the telecommunications marketplace, which will drive prices for communications services to costs and squeeze out the margins that might otherwise make possible the recovery of number portability deployment costs. In short, while the Commission could safely assume that carriers would still be able to recover their 800-access network upgrade costs in the absence of a specific recovery mechanism for those costs, future recovery of LNP implementation costs cannot similarly be taken for granted.

D. The Commission Should Preserve Competitive Carriers' Flexibility To Recover Costs and Grant Similar Flexibility to Incumbents.

U S WEST's opening comments noted that most CLECs are only lightly regulated and already possess the flexibility they need to recover their costs of implementing number portability from end users.[24] Those comments also suggested that affirmative regulation of these carriers' cost recovery methods by the Commission would be counterproductive. Most commenters addressing this issue agree with U S WEST's position.[25]

On the other hand, affirmative Commission action is required to give incumbent LECs this same flexibility to recover costs. As many commenters agree, "competitive neutrality" requires no less.[26] U S WEST has proposed guidelines that will enable carriers to

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[24] U S WEST at 22-23.

[25] *See, e.g.*, AT&T at 15-16; MCI at 9-10; Nextel at 4; Personal Communications Industry Association ("PCIA") at 3; Teleport at 10-12.

[26] *See, e.g.*, Ameritech at 7; Bell Atlantic at 2; Frontier at 3-4; NYNEX at 14; Sprint at 9-11.

recover costs and preserve accountability.[27] Of greatest importance is that the cost recovery mechanism permit incumbent carriers to recoup their implementation costs quickly. Given that incumbent LECs collectively will spend billions of dollars under the number portability mandate to create the very competitive regime that makes long-term recovery of these costs at best uncertain,[28] the promptest possible recovery is needed to ensure that recovery will indeed occur. Accelerated recovery ensures competitive neutrality by allowing incumbents to recover substantial portions of their costs of building the competitive regime before competition fully arrives, thus putting the incumbents and entrants on a more nearly level playing field once the entrants arrive. The Commission should therefore authorize all LECs to levy a number portability surcharge that allows them to recover their deployment costs over periods that are coterminous with the periods in which these costs are incurred.

II. The Commission Should Allocate Industrywide ("Type I") Costs to All Carriers on a National Basis, Based on Retail Telecommunications Revenues.

Although cost allocation issues have less of a financial impact on U S WEST than cost recovery issues, it recognizes the importance of allocation determinations. In its view, industrywide common costs ("Type I costs") present different concerns from carrier-specific costs ("Type II costs"): The former are incurred on a common basis by third-party administrators and are therefore necessarily pooled, while the latter are incurred separately by

27/ U S WEST at 16-22.

28/ The California Department of Consumer Affairs acknowledges the destabilizing effects the number portability mandate will have on incumbent LECs' customer bases and recognizes — from a consumer's point of view — the difficulty incumbents face in attempting to recover their lion's share of number portability costs from this ever shrinking base. CaDCA at 20-21.

individual carriers. For each category of costs, U S WEST urges adoption of the administratively simplest approach. Already-pooled Type I costs should be allocated to all carriers from one national pool on the basis of retail telecommunications revenues, while Type II costs should remain borne by the individual carriers who incur them. We address Type I costs in this part. Allocation of Type II costs is discussed in Part III, below.

A. The Commission Must Reject Proposals That Do Not Allocate Type I Costs Among All Telecommunications Carriers.

Section 251(e)(2) of the Communications Act unambiguously commands that "the cost of establishing . . . number portability shall be borne by all telecommunications carriers on a competitively neutral basis."[29] These costs necessarily include the costs of setting up one or more service management systems ("SMS") required by the Commission's long term database portability solution.[30] Congress defines the term "telecommunications carrier" to include "any provider of telecommunications services, except that such term does not include aggregators of telecommunications services."[31] The Commission has already interpreted this definition to mean that, "to the extent a carrier is engaged in providing for a fee domestic or international telecommunications, directly to the public or to such classes of users as to be effectively

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[29] 47 U.S.C. § 251(e)(2) (emphasis added).

[30] The cost of establishing number portability includes the costs of both setting up the regional SMSs as well as operating those systems, at least in the early years. Consequently, at least for the first three years, the total costs of establishing and operating the SMSs, including such costs as loading the databases and processing change orders, should be pooled and recovered from "all telecommunications carriers."

[31] 47 U.S.C. § 153(49) (emphasis added).

available directly to the public, the carrier falls within the [statutory] definition of 'telecommunications carrier.'"[32]

Despite this unambiguous statutory language, some commenters maintain that "all" does not really mean "all." Some commenters ask the Commission to allocate SMS costs only among those carriers who will impose costs on the SMS.[33] Other parties go further, arguing that only certain subsets of SMS users should bear the costs of establishing and maintaining the SMS databases.[34] Still others claim that they should receive individual exemptions from having to bear SMS costs because of their size, the technology they use, or some other reason.[35]

None of the policy or equity arguments made by these parties explains how Congress' specification of "all telecommunications carriers" can be read to mean "less than

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[32] Interconnection Order ¶ 992.

[33] *See, e.g.*, AT&T at 6-9 (recovery only from SMS users utilizing five SMS rate elements); Scherers at 2-3 (use 800 database model). *See also* CoPUC Staff at 5-6 (arguing, on the one hand, that "all . . . carriers without limitation must participate in LNP cost recovery," but also asserting that SMS costs "should be recovered from those carriers that use the database only"); Omnipoint at 2 and 3 (arguing, on the one hand, for per query charge on SMS users but later arguing that the Commission must allocate SMS costs to "all" carriers).

[34] MCI, Sprint, and TRA, for example, assert that IXCs, including those needing access to the SMS, should be excused from having to pay for SMS costs. *See* MCI at 3, 6 ("[A]ll local service providers participating local number portability should share in the recovery of LNP costs" and costs should be allocated "in proportion to total working telephone numbers"); Sprint at 6 (allocation to "all . . . carriers which provide local service . . . in proportion to each carrier's share of presubscribed local service lines."); Telecommunications Resellers Association ("TRA") at 5 (SMS cost recovery "should be limited to carriers providing local exchange service."). *See also* CaDCA at 13 and 18 (only from carriers operating in areas where number portability is implemented); General Services Administration ("GSA") at 7-8 (only those carriers assigned telephone numbers).

[35] Finally, some commenters simply argue that the Commission should find some reason to exclude them from having to contribute anything towards any SMS costs. *See, e.g.*, ITCs at 1-3 (exclude rural telephone companies); National Telephone Cooperative Association/Organization for the Promotion and Advancement of Small Telephone Companies ("NTCA/OPASTCO") at 2-5 (same); PCIA at 5 (exclude paging, messaging, and non-covered SMR licensees); TRA at 10 (appearing to contend that resellers should be exempted from contributing towards SMS costs).

all."[36] As a large number of commenters agree, the plain language of the Communications Act prevents the Commission from adopting an allocation method that does not assign shares of SMS costs to all carriers.[37]

B. For the Present, the Commission Should Allocate Type I Costs on the Basis of Retail Telecommunications Revenues.

Congress has directed not only that industry number portability costs be allocated among all carriers, but also that the allocation method chosen by the Commission be "competitively neutral."[38] U S WEST believes this test requires that carriers contribute on the basis of their retail telecommunications revenues, an approach supported by many carriers.[39]

Number portability is a means of increasing competition for customers at the retail level, and the costs of establishing a portability architecture should accordingly be spread over (and recovered from) all retail end users by the carriers who serve them. This in turn

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36/ As WinStar has stated, "If Congress had intended to exclude a class of carriers from the section's requirements based upon size, type of service, geographic service area, or any other distinction, it certainly possessed the knowledge and ability to do so." WinStar at 4. *See, e.g.*, MCI v. AT&T, 104 S. Ct. 2223, 2232 n.4 (1994) (FCC and courts "are bound, not only by the ultimate purposes Congress has selected, but by the means it has deemed appropriate, and prescribed, for the pursuit of those purposes.").

37/ *See, e.g.*, Ameritech at 4-5; Bell Atlantic at 4; CaPUC at 5; Florida Public Service Commission ("FlaPSC") at 3; Frontier at 3-4 and n.8; MFS at 2 and 6-7; Nextel at 3-4; NYNEX at 5; Pacific Telesis at 3-4; SBC at 3-6; Teleport at 4; Time Warner at 3-5; USTA at 14; WinStar at 3-4.

38/ *See* 47 U.S.C. § 251(e)(2) ("The cost of establishing . . . number portability shall be borne by all telecommunications carriers on a competitively neutral basis as determined by the Commission."). This competitive neutrality requirement means that the Commission cannot entertain requests that portability costs be allocated exclusively to the "beneficiaries" of portability (that is, to new entrants). *See, e.g.*, ITCs at 1-3; NTCA/OPASTCO at 2-5.

39/ U S WEST has advocated this approach in its comments regarding the funding of universal service. Comments of U S WEST, CC Docket No. 96-45, at 16-20. *See also, e.g.*, Ameritech at 6 ("gross telecommunications retail sales"); Bell Atlantic at 5 ("gross retail telecommunications service revenues"); NYNEX at 7-9 ("total telecommunications service retail revenues").

requires distributing common costs among carriers for recovery on the basis of their proportion of retail end users. An allocation based on retail telecommunications revenues best distributes costs among carriers in proportion to their retail presence — that is, in proportion to their ability to spread common costs in the retail market.

The alternative criteria suggested by some commenters are less accurate proxies for the retail presence of each carrier. Several commenters urge the use of gross telecommunications revenues net of payments made to other carriers.[40/] Any net-of-payments rule would fail to adequately reflect the retail presence of carriers that resell finished services or purchase unbundled network elements for resale, strategies that the Communications Act actively encourages. A net-of-payments rule also would undercount the retail customers of carriers that pay access charges and would understate their ability to spread number portability costs.[41/] Similar defects hamper the non-revenue based allocators suggested by some carriers: a minutes-of-use allocator[42/] would ignore the contributions made by non-MOU services such as flat-rated local and private line services, and an allocator based on the number of telephone

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40/ *See, e.g.*, Association for Local Telecommunications Services ("ALTS") at 4; FlaPSC at 3; Frontier at 4; MFS at 7; NTCA/OPASTCO at 9; Nextel at 2-3; Teleport at 4-6; Time Warner at 8-9; TRA at 7-8; and WinStar at 5-6.

41/ Assume two carriers, A and B, each with retail revenues of $100. With an allocator based on retail revenue, each carrier would contribute the same sum towards the SMS, and each would recover the same sum from its own retail customers.

Assume now that in the provision of its services Carrier B purchases $50 of "wholesale" services or network elements from Carrier A. Under the "gross revenues less payments to other carriers" approach, Carrier B's allocation of SMS costs would be based on $50 of revenues which, in turn, it would recover from retail customers generating $100. In contrast, Carrier A's allocation of SMS costs would be based on $150 of revenues ($100 retail + $50 wholesale) which it would have to recover from end users generating only $100 in retail revenues. Clearly, a net gross revenues allocator is not competitively neutral.

42/ *See, e.g.*, AirTouch at 7-10.

numbers assigned to a carrier[43] would exempt entirely carriers, such as IXCs, who have an obvious retail presence but are assigned no telephone numbers.

In any event, the Commission should not be locked into a single allocation method for all time. U S WEST suggests that the Commission allocate common costs on the basis of retail telecommunications revenues for the next three years and, shortly before that time expires, revisit the subject to determine whether the allocation should be adjusted. We propose an initial term of three years because the bulk of the regional SMS costs will constitute capital associated with equipment purchases, and this capital should be depreciated fully over a period no longer than three years.[44]

C. A National SMS Cost Allocation Plan Would Be Administratively Simplest and Least Burdensome.

Type I costs are necessarily pooled: Neutral, third-party administrators will incur the costs to construct and operate SMSs on behalf of all carriers in the industry, and those costs must be divided among individual carriers. A number of commenters suggest that the Commission should treat each regional SMS as a different pool, so that each SMS administrator would recover its costs from the telecommunications revenues that are generated within the region served by that SMS.[45] But such a system would require a separate set of allocation

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43/ *See, e.g.*, GSA at 6-8; MCI at 5-6.

44/ Rapid depreciation is necessary not only to avoid having regional SMS administrators facing obsolete equipment with an unrecovered depreciation reserve deficiency, but also to minimize the increased total costs resulting from increased carrying charges resulting from a longer depreciation life term.

45/ *See, e.g.*, Ameritech at 5; CaDCA at 14; CaPUC at 6; FlaPSC at 4; ICC at 5; ITCs at 2; Time Warner at 8.

calculations for each regional and state-specific SMS established. To reduce this administrative complexity, U S WEST and others suggest instead that allocation take place from a single national pool.[46] This would reduce administrative burdens for both carriers and SMS administrators, simplify the task of establishing the regional SMSs, and increase the chance that the regional SMSs will be operational in time to meet the Commission's number portability implementation schedule.[47]

A regional approach would create administrative complexity. A carrier serving multiple regions — such as CMRS providers, whose service areas frequently cross wireline service region boundaries — would need to allocate its revenues among the different regions. This accounting process would become more burdensome as individual carriers began to provide a wider range of services. Similarly, SMS administrators would have to develop billing systems, as well as collections processes in the event carriers fail to make timely payments. This would complicate the task of getting the SMS up and running, inviting new delays in commencement, and increasing overall SMS costs to be passed on to carriers and to consumers.

Furthermore, any approach requiring interregional allocation of revenues is an invitation for intercarrier disputes; adding a level of accounting complexity invites charges that carriers have used the process to conceal revenues from regulators or shift them to competitors.

46/ *See, e.g.*, Cellular Telecommunications Industry Association ("CTIA") at 2-3; PCIA at 6-7; and TRA at 7.

47/ As noted in our petition for reconsideration and clarification of the First Report and Order, the Commission's assumption that the regional SMSs can be tested and fully operational by October 1, 1997 is overly optimistic. The Commission should defer the implementation process until it has established a comprehensive cost recovery mechanism and until all carriers have had time for field testing. *See* U S WEST Petition for Reconsideration and Clarification, CC Docket 95-116, at 5-11, 15-17 (Aug. 26, 1996).

The intricacies of accounting provide the opportunity for multiregion carriers to hide revenues from the various regional administrators. Giving carriers the flexibility to conduct their own internal allocation audits would inevitably result in concerns that, during this internal process, some revenues were dropped and, as a result, never reported to any regional SMS administrator.

A national cost recovery plan would be far more efficient and cost effective. Carriers could avoid internal allocation audits because they would instead report their total retail telecommunications revenues to the Commission. SMS administrators would likewise submit their budgets to the Commission, and the Commission would write a handful of checks to the administrators from the funds deposited by carriers.[48]

These same concerns about accounting and administrative burdens confirm the Commission's tentative conclusion to require states opting out of the regional databases and building their own databases nevertheless to abide by the Commission's national pricing standards and allocation mechanism.[49] If carriers must allocate revenues specially for the several states that create their own SMSs, they will be subject to the accounting headaches and potential intercarrier disputes described above. The Commission's apparent reasons for allowing states to opt out of the regional databases — solicitude for the vendors who have already received state database administration contracts and for the state procurement authorities who

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48/ Submitting funds to the Commission rather than regional SMS administrators will likely decrease the risk of collections problems.

49/ FNPRM, 11 FCC Rcd at 8460. Other carriers agree. *See, e.g.*, ALTS at 3; MFS at 8; Teleport at 6-7.

have already issued requests for proposals[50] — furnish no justification for imposing these additional administrative costs upon multistate carriers.

III. No Carrier Should Be Required To Subsidize Another Carrier's Specific ("Type II") Implementation Costs.

As noted above, Type I costs are necessarily pooled because they are commonly incurred; administrative economy suggests that there should be only one pool instead of many. The situation with carrier-specific costs ("Type II costs") is just the reverse. By definition, these costs are incurred by carriers individually. Artificially aggregating these individually incurred costs into pools for redistribution, as some commenters suggest,[51] only creates administrative complexity.

Pooling creates incentives for carriers to overinvest in their networks because each carrier receives the full benefit of any investment it makes but may bear only a fraction of that investment's cost — namely, its fraction of the revenue pool. To address the risk of overinvestment, regulators must police the submitted costs closely, and this adds costs to the system both in increased regulatory effort and in greater accounting burdens on carriers. These administrative costs are passed on to end users of communication services. It may be true, as some commenters claim, that under a pooling arrangement all callers will see the same number portability surcharge on their bills no matter who their carrier may be;[52] however, because of

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[50] First Report and Order, 11 FCC Rcd at 8402.

[51] *See, e.g.*, GTE at 2-3; NYNEX at 9-10; PCIA at 4-5; SBC at 10-11; USTA at 12-13.

[52] *See, e.g.*, NYNEX at 12-13; SBC at 14.

these administrative costs, the average surcharge will be higher than it would have been without pooling.

U S WEST therefore agrees with the broad cross-section of ILECs, CLECs, IXCs, and CMRS providers who suggest that each facilities-based carrier should bear its own costs (and only its own costs) of implementing number portability.[53] Thereafter, each carrier must be empowered to recover the full measure of those borne costs, but this recovery cannot come from other facilities-based carriers. Each carrier must recover its costs from its own end users (including resellers) and from purchasers of unbundled network switching who rely on the unbundling carrier to provide number portability. Recovery from resellers and purchasers of unbundled switching (to the extent that number portability costs are not included in unbundled rates) is essential to prevent these groups of carriers from receiving the benefits of number portability without having to bear any of the costs of providing it.[54] Failure to allow recovery from these groups would distort the market in favor of non-facilities-based competitors and violate "competitive neutrality" by artificially inflating the price of facilities-based entry.

CONCLUSION

For the foregoing reasons, and for those stated in its initial comments, the Commission must ensure that incumbent LECs have the opportunity to recover the substantial costs they must bear to meet the federal mandate. Incumbent LECs should be able to recover

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[53] *See, e.g.*, ALTS at 6-7; AT&T at 12-14; Frontier at 1-3; MFS at 2-3; Omnipoint at 2; PacTel at 10-11; Sprint at 8; Teleport at 7-8.

[54] *See, e.g.*, Ameritech at 4-5, 7; Bell Atlantic at 6-7; Omnipoint at 4-5; USTA at 15-16.

those costs over the same time period that the investments are made. The creation of an explicit, distinct federal number portability surcharge will enable carriers to recover their costs in a competitively neutral fashion and will best support the goals of Congress and the Commission. In addition, the Commission should allocate Type I costs on a national basis, based on retail telecommunications revenues. In contrast, each carrier should bear its own Type II costs so that the administrative complexities and burdens of pooling are avoided.

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